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Re: Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance; OCC Docket OCC-2011-0024; FRB Docket No. OP-1431; FDIC RIN No. 3064-ZA00; FCA RIN 3052-AC46; NCUA RIN 3133-AD41

Dear Sir or Madam:

We are writing to you today on behalf of our client, a bank that that has a significant interest in servicing issues, in response to your proposed Interagency Questions and Answers Regarding Flood Insurance. We applaud the Agencies[1] for considering the comments submitted in response to the 2009 Questions and Answers and for reconsidering certain of the positions taken in that Interagency guidance. We fully support the Agencies' conclusion that a lender/servicer has the right to charge a borrower for lender-placed flood insurance coverage for any part of the 45-day

[1] The Agencies collectively refer to the Farm Credit Administration, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

notice period in which no adequate borrower-purchased flood insurance coverage is in effect because the insurance was cancelled, expired or not renewed. We strongly believe that the National Flood Insurance Reform Act of 1994 (the "Act") provides lenders and servicers with the statutory authority needed to charge borrowers for lender-placed insurance; and, accordingly, we are have significant concerns regarding the Agencies imposing conditions on that authority.

More specifically, we have significant concerns regarding the Agencies proposed revised Answer to Question #62, which would require borrower payment only if certain conditions are present. We believe that the revised answer to Question #62 is counter to the purpose and language of the Act, does not encourage life of loan coverage, does not confirm the servicer's ability to charge for lender-placed insurance and raises more questions than it answers. Thus, with this comment letter, we do two things. First, we encourage the Agencies to revise the proposed Answer to Question #62 in two specific ways: (i) omit the "express" language; and (ii) eliminate the requirement that borrowers and lenders receive a "benefit" from the insurance. Second, we respond to the Agencies' question posed in the guidance regarding the existence of "double" insurance coverage for 30-days following the expiration of the original flood insurance term.

I. BACKGROUND

In 1996, in response to the National Flood Insurance Reform Act of 1994, the Agencies[2] issued a joint final rule to update their flood insurance regulations.[3] Following the publication of this joint rule, the Agencies received a number of requests to clarify some issues brought to light by the joint rule. In light of the level of detail and diversity of these requests, the Agencies believed that they would be best addressed via supervisory guidance. Accordingly, the Federal Financial Institutions Examination Council ("FFIEC") published the Interagency Questions and Answers in 1997 (the "Interagency Guidance").[4]

In 2009, the Agencies issued an update to the Interagency Guidance and, as part of this update, proposed certain new Questions and Answers relating to lender-placed insurance (the "2009 Answers").[5]

Of the proposed 2009 Answers, the Agencies are adopting two[6] and withdrawing one.[7] With respect to the remaining two Questions and Answers (#60 and #62), the Agencies are proposing

[2] Prior to 2011, references to the Agencies also included the Office of Thrift Supervision.

[3] 61 Fed. Reg. 45,684 (Aug. 29, 1996).

[4] 62 Fed. Reg. 39,523 (July 23, 1997).

[5] 74 Fed. Reg. 35,914 (July 21, 2009).

[6] The two Questions and Answers the Agencies adopted are #9 and #61.

to substantively change their 2009 Answers.[8] More specifically, in light of the majority of commenters that warned the Agencies that the 2009 Answer to Question 62 could cause certain adverse unintended consequences (*i.e.*, gaps in insurance coverage, threats to safety and soundness), the Agencies are proposing the following new Answer (the "Revised Answer"):

> **Question 62:** When may a lender or its servicer charge a borrower for the cost of insurance that covers collateral during the 45-day notice period?
>
> **Answer:** A lender or its servicer may charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance coverage is in effect, if the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made. Any policy that is obtained by a lender or its servicer, the premium of which is charged to the borrower pursuant to a contractual right, should be equivalent in coverage and exclusions to an NFIP policy and cover the interests of both the borrower and the lender.
>
> The Agencies encourage institutions to explain their force-placement policies to borrowers (including their policy on charging for force-placement coverage for the 45-day period and the timing of that change) and encourage lenders and servicer to escrow flood insurance premiums. Following these recommendations could result in less force placement of flood insurance. Further, Regulation Z requires lenders to establish an escrow account for the payment of property taxes and mortgage-related insurance required by the lender, including flood insurance, for all "higher priced" first-lien mortgage loans.

Essentially, this new Answer permits lenders and servicers to charge borrowers for insurance coverage for any part of the 45-day notice period, provided the following conditions are met: (i) the borrower has given the lender or its servicer express authority to charge the borrower for such coverage as a contractual condition of the loan; (ii) the policy is equivalent in coverage and exclusions to a National Flood Insurance Program ("NFIP") policy; and (iii) the policy covers the interests of both the borrower and the lender.[9] For the reasons set forth below in Part II, we urge the Agencies to eliminate the conditions on express authority and benefit to the borrower, or, in the alternative, apply these conditions only prospectively to loans originated after a reasonable compliance date to give lenders and investors time to amend the loan agreements to be compliant with these conditions.

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[7] The Agencies are withdrawing Question and Answer #10.

[8] The Agencies also are revising the Answer to Question #57 to provide consistency with the Answers to #60 and #62 published in this Interagency guidance.

[9] 76 Fed. Reg. 64,180 (October 17, 2011).

II. ARGUMENTS IN FAVOR OF ELIMINATING CONDITIONS

We are deeply concerned that the conditions placed by the Agencies on the ability of lenders and servicers to charge for flood insurance premiums during the 45-day notice period fails to further the statutory purpose of the Act, which is to ensure for continuous coverage.[10]

A. "Express" Condition Does Not Reflect Loan Agreements In Use

We urge the Agencies to omit this phrase from the Revised Answer:

> [I]f the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made.

We are concerned that this condition assumes a degree of certainty and homogeny among existing loan contracts that simply does not exist. In fact, we are aware that some loan documents do not even contain language that directly addresses the payment of flood insurance premiums. We remind the Agencies that no lender entered into or drafted loan documents knowing that the lender or servicer would be permitted to charge for lender-placed flood insurance only if the loan document provided for *express authority.* In fact, until 2009 lenders and servicers had no reason to doubt their legal authority to collect these premiums from borrowers since the Act provides clear authority to collect for these payments independent of the loan agreement.[11]

Consider the variety of language on which lenders and servicers currently rely (and have relied on without question for decades) that exists in loan documents that are in use today:

Sample "A"

> ¶ 6. That he will keep the improvements now existing or hereafter erected on the mortgaged property, insured as may be required from time to time by the mortgagee against loss by fire and other hazards, casualties and contingencies in such amount and for such period as may be required by the mortgagee, and will pay promptly, when due, any premiums on such insurance for payment of which provision has not been made hereinbefore.
>
> ¶ 8. That if default be made in the payment of any of the installments provided for in paragraph 2 hereof for taxes, assessments, fire and other hazard insurance, and mortgage insurance, or in the event of the failure of the mortgagor to keep the buildings on said

[10] The Agencies acknowledge in the Interagency guidance that the loan must maintain "continuous flood insurance coverage during the life of the loan." 76 Fed. Reg. 64,179 (October 17, 2011).

[11] "[T]he lender or servicer for the loan shall purchase the insurance on behalf of the borrower and may charge the borrower for the cost of premiums and fees incurred by the lender or servicer for the loan in purchasing the insurance." 42 U.S.C.S. § 4012a(e)(2).

premises and those to be erected on said premises, or improvements thereon, in good repair, said mortgagee may pay such taxes, assessments, mortgage and hazard insurance, make such repairs as in its discretion it may deem necessary properly to preserve the property and any sums so paid shall be a further lien on such premise under this mortgage, payable forthwith, with interest at the rate set forth in the note secured herby until paid.

Sample "B"

¶ 4. Fire, Flood and other Hazard Insurance. . . . Borrower shall also insure any improvements on the Property, whether now in existence or subsequently erected, against loss by floods to the extent required by the Secretary.

¶ 6. Charges to Borrower and Protection of Lender's Rights in the Property. . . . If Borrower fails to make these payments or the payments required by Paragraph 2, or fails to perform any other covenants and agreements contained in this Security Instrument, or there is a legal proceeding that may significantly affect Lender's rights in the Property (such as a proceeding in bankruptcy, for condemnation or to enforce laws or regulations), then Lender may do and pay whatever is necessary to protect the value of the Property and Lender's right in the Property, including payment of taxes, hazard insurance and other items mentioned in Paragraph 2. Any amounts disbursed by Lender under this Paragraph shall become an additional debt of the Borrower and be secured by this Security Instrument. These amounts shall bear interest from the date of disbursement, at the Note rate, and at the option of Lender, shall be immediately due and payable.

Sample "C"

¶ 6. They will continuously maintain hazard insurance, of such type or types and amounts as the holder of the note may from time to time require on the improvements now or hereafter on the said premises, and except when payment for all such premiums has theretofore been made under (a) of paragraph (2) herefor, they will pay promptly when due any premiums therefor.

¶ 12. The holder of the said note shall have the right to pay any taxes, assessments, water rates, and any other governmental or municipal charges, fines or imposition which are to be paid under paragraph 5 hereof, and to make any payments hereinabove provided to be made by the Grantors under subsection (a) of paragraph 2 hereof, and any amount so paid by the said holder shall then be added to the principal debt named herein and bear interest at the rate provided for in the principal indebtedness, payable monthly from the date of such payment and be secured by this Deed of Trust the same as sais principal debt and interest thereon;

The Agencies have not provided guidance regarding whether the language, such as the samples provided above, constitutes "express authority" as contemplated in the Revised Answer. For example, what level of detail is needed? Must the language specifically identify flood insurance? Must the language specifically identify lender-placed flood insurance? Must the language specifically identify lender-placed insurance during the 45-day notice period? Certainly the Agencies can appreciate that in this time of heightened regulatory scrutiny on banks by their prudential regulators lenders and servicers should not have to guess at their compliance.

Requiring express authority in the loan agreements does not promote any public policy. It does not further the purpose of the Act to provide for continuous flood insurance coverage. It does not support lenders' and servicers' ability to place insurance. Rather, it requires lenders and servicers to scour each individual loan agreement to determine the extent to which the lender or servicer is expressly authorized to charge insurance premiums even though every borrower receives notice that flood insurance is required and will be lender-placed if not maintained. Accordingly, the Agencies condition does nothing to protect the consumer, but it does increase the compliance burden and cost on all lenders and servicers.

Thus, we strongly urge the Agencies to remove the phrase that requires express authority.

B. "Benefits" to Borrower Is An Ambiguous Standard

We urge the Agencies to omit this phrase from the Revised Answer:

> [A]nd cover the interests of both the borrower and the lender.

Again, similar to our concerns over the "express authority" a lender or servicer should not have to question long-standing industry practices and standards because the Agencies have created a condition on payment without any statutory authority and without any guidance regarding what benefit to the borrower is sufficient to meet the Agencies' requirements. We are concerned about this language because it is unclear what the Agencies would consider to constitute a sufficient benefit to meet this condition. It is possible that the Agencies could interpret this new condition to require coverage to protect the borrower's equity position or personal property, which coverage is *in excess of current legal requirements* and is inconsistent with industry practices and standards.

Again, it furthers no public policy to retroactively impose a condition that does not further the goals of the Act and that is counter to existing industry practices.

III. CLARIFICATION OF "DOUBLE" COVERAGE OF 30-DAYS

Notwithstanding general perceptions, there is no 30-days of "free" coverage of flood insurance. Consider the language from the NFIP policy:

- This policy will expire at 12:01 a.m. on the last day of the policy term.
- We must receive the payment of the appropriate renewal premium within 30 days of the expiration date.

The above language does not create a 30-day grace period during which the borrower is not obligated to pay a premium. Rather, it provides a compliance period for the borrower not unlike the 45-day notice period.

This concept is best understood by acknowledging that the expiration of a flood insurance policy requires one of two things to happen – either the borrower "cures" the lapse by voluntarily obtaining insurance within 30 days or the lender places insurance after the 45 day notice period.

In practice, if a borrower were to voluntarily obtain coverage after expiration, but within the 30-day grace period, then the policy would be effective as of the expiration date. If the borrower were to do nothing and allow the lender to place the insurance, then the lender-placed policy would, again, be effective as of the expiration date. In this latter alternative, the 30-day "compliance" period is irrelevant because the borrower chose not to obtain coverage. Thus, there is no situation under which the borrower receives 30 days of "free" coverage.

IV. RECOMMENDATION AND CONCLUSION

We applaud the Agencies for listening to the comments received and reconsidering the 2009 Answers relating to lender-placed insurance. Nevertheless, we urge the Agencies to continue to modify the Revised Answer to Question #62 to avoid raising additional questions and to ensure that the goals of the Act are met.

Simply, we believe that the Act does not require the lender to pay for any lender-placed insurance, and, accordingly, any response drafted by the Agencies should reflect as much. To accomplish this, we believe that the Agencies should remove the conditions that they have placed on borrower payment of premiums during the 45-day notice period as follows:

> **Question 62:** When may a lender or its servicer charge a borrower for the cost of insurance that covers collateral during the 45-day notice period?
>
> **Answer:** A lender or its servicer may charge a borrower for insurance coverage for any part of the 45-day notice period in which no adequate borrower-purchased flood insurance coverage is in effect~~, if the borrower has given the lender or its servicer the express authority to charge the borrower for such coverage as a contractual condition of the loan being made~~. Any policy that is obtained by a lender or its servicer, the premium of which is charged to the borrower pursuant to a contractual right, should be equivalent in coverage and exclusions to an NFIP policy ~~and cover the interests of both the borrower and the lender~~.

> The Agencies encourage institutions to explain their force-placement policies to borrowers (including their policy on charging for force-placement coverage for the 45-day period and the timing of that change) and encourage lenders and servicer to escrow flood insurance premiums. Following these recommendations could result in less force placement of flood insurance. Further, Regulation Z requires lenders to establish an escrow account for the payment of property taxes and mortgage-related insurance required by the lender, including flood insurance, for all "higher priced" first-lien mortgage loans.

In the alternative, if the Agencies cannot eliminate the conditions as requested, then they must apply them only *prospectively* to those loan agreements where lenders and investors can draft clear language to ensure compliance. Lenders and servicers should not suddenly find themselves in a situation where loan agreements drafted years ago without the benefit of this Interagency guidance prevent them from collecting premiums that were contemplated to be paid by the borrower, but were not sufficiently expressed within the four corners of the loan agreement.

We appreciate the Agencies' time and attention to this important issue, and we look forward to working with the Agencies to craft language that promotes the goal of the Act to ensure continuous flood insurance coverage.

Respectfully,

Suzanne F. Garwood